



LETTER RULING

Letter Ruling 18-1: Impact of Federal 338(h)(10) Election on Certain Corporate Excise Credits

DATE:

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REFERENCED SOURCES:

[Massachusetts General Laws](#)

You request certain rulings on the tax consequences of a transaction previously entered into by ***** (“Purchaser”), a ***** corporation headquartered in ***** (“Target”), a ***** corporation headquartered in ***** , and Target’s prior shareholders (“Sellers”). Target is an “S corporation” as defined in federal Internal Revenue Code (“Code”) section 1361(a)(1).

STATEMENT OF FACTS

The following is your representation of the facts upon which we base this letter ruling.

Purchaser and Target both manufacture ***** . On ***** , Purchaser acquired 100% of the stock of Target (the “Transaction”). Prior to the Transaction, Target took approximately ***** in Massachusetts economic opportunity area credits (“EOACs”) pursuant to G.L. c. 63, § 38N from ***** , and approximately ***** in Massachusetts investment tax credits (“ITCs”) pursuant to G.L. c. 63, § 31A from ***** . After the Transaction, all of the credit-generating assets owned by Target at the time of the Transaction were still owned and in use by Target in Massachusetts, and Target continued to manufacture ***** in Massachusetts.

Purchaser and Sellers agreed to elect under Code section 338(h)(10) (“338(h)(10) election”) to treat the Transaction as an asset purchase for federal income tax purposes. When parties to a transaction jointly make a 338(h)(10) election, the target corporation is treated as though it were two separate corporations: “Old T” and “New T”. 26 CFR § 1.338(h)(10)-1(d)(3). Old T is treated as having transferred all of its assets to New T in exchange for consideration in a single transaction, and Old T recognizes all of the gain or loss realized on this deemed sale of its assets. *Id.* New T’s basis in the assets deemed acquired is equal to the allocated value of said assets, which is based on the sales price of T’s stock as reported on IRS Form 8883. See 26 CFR 1.338-5.

RULINGS REQUESTED

1. Whether the sale of stock pursuant to a transaction for which a 338(h)(10) election is made (a “338(h)(10) transaction”) is treated for Massachusetts tax purposes as a disposition of “qualifying property”¹ that triggers recapture of Massachusetts ITCs and EOACs previously taken by the target corporation with respect to such property.
2. Whether the purchaser of stock in a 338(h)(10) transaction is allowed Massachusetts ITCs with respect to qualifying property held by the target corporation.

RULINGS

1. The sale of stock in a 338(h)(10) transaction is treated as a disposition of the assets held by the target for purposes of the ITC and EOAC, and therefore ITCs and EOACs previously taken by the target corporation with respect to those assets are subject to the recapture provisions of G.L. c. 63, § 31A(e).
2. The target corporation in a 338(h)(10) transaction is treated as having acquired the qualifying property in the transaction and therefore is allowed ITCs with respect to such property. The purchaser of the target stock is not allowed ITCs with respect to qualifying property held by the target corporation, because the purchaser does not own the property directly.

LAW AND ANALYSIS

I. Relevant Law

A. Fiction created by 338(h)(10) election

In certain circumstances, when a purchasing corporation acquires the stock of a target corporation from the target corporation’s shareholders, the purchasing corporation and the target corporation may elect under Code section 338(h)(10) to treat the transaction as an asset purchase for federal income tax purposes. If such an election is made, the following fiction is treated as having occurred for federal income tax purposes: (i) the target corporation is treated as if it is two unrelated corporations, “Old T” owned by

the target corporation's shareholders before the transaction, and "New T" owned by the purchasing corporation after the transaction; (ii) Old T is treated as if it transferred all of its assets to New T in exchange for consideration that includes the discharge of its liabilities in a single transaction at the close of the acquisition date; and (iii) Old T is deemed to liquidate following the transaction. See 26 CFR § 1.338(h)(10)-1(a)(1).

As a result of a 338(h)(10) election, for federal income tax purposes, Old T recognizes gain (or loss) equal to the difference between the "aggregate deemed sales price"² ("ADSP") and the tax basis of its assets. 26 CFR 1.338(h)(10)-1(d)(3). If Old T is an S corporation (as is the case in the facts presented), its gain flows through to Old T's shareholders, who will recognize the gain on their individual returns, and then Old T is treated as having distributed an amount equal to the ADSP to its shareholders in a liquidation. 26 CFR 1.338(h)(1)-1(d)(5).

B. Recapture rules for ITCs and EOACs

Certain corporations are allowed an ITC equal to 3.0% of the cost (or other basis for federal income tax purposes) of qualifying tangible property acquired, constructed, reconstructed, or erected during the taxable year, after federal tax deductions are taken on the property. G.L. c. 63, § 31A(a). Additionally, for tax years beginning before January 1, 2010, corporations with property eligible for the ITC were permitted to forgo the ITC with respect to that property and instead take an EOAC equal to 5.0% of the federal basis of the property, provided that the property was acquired, constructed, reconstructed or erected during the taxable year and used exclusively in a certified project in an economic opportunity area in Massachusetts. G.L. c. 63 § 38N(a) (as in effect for projects certified prior to January 1, 2010).³ However, a taxpayer is subject to the recapture provisions of G.L. c. 63, § 31A(e) if it disposes of property on which ITCs had been taken prior to the end of the property's useful life. G.L. c. 63, § 31A(e). For projects certified before January 1, 2017, EOACs were also subject to the recapture provisions of G.L. c. 63, § 31A(e). G.L. c. 63, § 38N(a) (as in effect for projects certified prior to January 1, 2017).⁴ If such a disposition occurs, the difference between the credit taken and the credit allowed must be added back as additional tax due in the year of disposition. G.L. c. 63, § 31A(e). A taxpayer determines the amount of the credit allowed by multiplying the full amount of the credit by the ratio which the months of qualified use bear to the months of property's useful life. *Id.*

II. Analysis

A. The 338(h)(10) election constitutes a disposition, triggering a recapture of Target's ITCs and EOACs

The question raised by this ruling request is whether the federal treatment of a 338(h)(10) transaction as an asset sale is followed for Massachusetts tax purposes such that it will trigger credit recapture associated with the disposition of assets on which ITCs and EOACs were previously taken.

When Sellers and Purchaser elected under Code § 338(h)(10) to treat the Transaction as a sale of Target's assets, several federal tax consequences followed: (i) the basis of Target's assets was adjusted based on the amount Purchaser paid Sellers to acquire Sellers' Target stock, (ii) Target recognized gain as if it transferred all of its assets to an unrelated person, and (iii) the recognized gain was passed through to Sellers. Each of these consequences also follows for Massachusetts corporate excise purposes. See *General Mills v. Commissioner of Revenue*, 440 Mass. 154, 170, 173-174 (2003) (target in transaction subject to 338(h)(10) election required to include gain realized from fictional sale of assets in its Massachusetts net and gross income where Court recognizes target will use federal adjusted basis to determine the basis of its assets for Massachusetts tax purposes). See also G.L. c. 63, § 38(n) (receipts derived from a 338 deemed asset sale are includable in target's sales factor for apportionment purposes). Because Massachusetts generally follows the federal treatment of a 338(h)(10) election for corporate excise purposes, that treatment follows also in this case. Target's assets are treated as having been disposed of for purposes of calculating basis and gain, and therefore will also be treated as having been disposed of for credit recapture purposes.

This ruling is further supported by the fact that Massachusetts' rules relating to the ITC and EOAC are closely tied to provisions of the Code. In particular, the ITC and EOAC are both calculated based on the cost or other basis for federal tax purposes of the credit-generating property. See G.L. c. 63, § 31A(a); 830 CMR 63.38.1(6)(a).⁵

B. Target, not Purchaser, is eligible to take new ITCs

A corporation is allowed ITCs for qualifying tangible property acquired, constructed, reconstructed, or erected during the taxable year. G.L. c. 63, § 31A(a). A 338(h)(10) transaction is treated as both a disposition of assets subjecting Target to the recapture provisions of G.L. c. 63, § 31A and as an acquisition of those same assets. Therefore, inasmuch as Target recognized gain (or loss) and recapture on the disposition of its assets, it is also allowed new ITCs under G.L. c. 63, § 31A(i) on the acquisition of qualifying property in the Transaction.⁶

III. Conclusion

For Massachusetts corporate excise purposes, the Transaction is treated as a disposition of Target's assets, and therefore Target will be subject to the recapture provisions of G.L. c. 63, §§ 31A and 38N. However, the Transaction will also qualify as an acquisition of qualifying property by Target, and therefore Target will be allowed new ITCs.

Very truly yours,

/s/Christopher C. Harding

CCH:RHF:jt

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¹ See G.L. c. 63, § 31A, which authorizes ITCs for investments in qualifying property, defined as “tangible personal property and other tangible property including buildings and structural components of buildings acquired by purchase, as defined under [Code] section [179(d)] used by the corporation in the commonwealth; situated in the commonwealth on the last day of the taxable year; and which (1) is depreciable under [Code] section [167] and has a useful life of four years or more, or (2) is considered recovery property under [Code] section 168....”

² See 26 CFR 1.338-4(a), (b), which define aggregate deemed sales price as the amount for which Old T is deemed to have sold all of its assets in the deemed asset sale.

³ Stat. 2009 c. 166 § 23 amended G.L. c. 63, § 38N for projects certified on or after January 1, 2010. However, all EOAC credit-generating activity of Target occurred prior to the effective date of that statutory amendment.

⁴ Stat. 2016 c. 219 § 85 amended G.L. c. 63, § 38N effective for projects certified on or after January 1, 2017.

⁵ We note also that our ruling comports with the analysis in *Commissioner of Revenue v. Gillette*, 454 Mass. 72 (2009). In *Gillette*, the Supreme Judicial Court held that there was no ITC recapture when a subsidiary holding the qualifying assets was liquidated into a parent corporation and the parent was “in substance if not in form... engaged in a mere continuation of [the subsidiary’s] activities with respect to the assets at issue.” *Id.* at 77. In contrast to the transaction at issue in *Gillette*, the Transaction resulted in an actual change in the ultimate ownership of Target from Sellers to Purchaser and a deemed transfer of assets for tax purposes from Old T to New T. Moreover, unlike in *Gillette*, the Transaction resulted in a recognition of gain and an adjustment to the basis in assets transferred.

⁶ We do not reach a conclusion regarding whether Purchaser and/or Target will be eligible to apply for and/or take EOACs for property transferred pursuant to the Transaction, as you have not requested that we engage in such an analysis.

